

## Internal Revenue Service

Number: **200411012**

Release Date: 03/12/2004

Index Number: 382.12-06

Department of the Treasury  
Washington, DC 20224

Person To Contact:

, ID No.

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Refer Reply To:

CC:CORP:B01 – PLR-137406-03

Date:

December 05, 2003

### Legend:

Taxpayer =

Shareholder A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

a =

\$b =

c =

d =

\$e =

f =

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g =\$h =\$i =i =\$k =\$l =\$m =n% =o =\$p =q =r =s =\$t =\$u =v =\$w =

Class 1 Preferred Stock =

Class 2 Preferred Stock =

Class 3 Preferred Stock =

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Dear

This letter responds to your letter dated June 12, 2003, which requests a ruling on the application of § 382(l)(3)(C) to Taxpayer as a result of a proposed transaction. Additional information was received in letters dated November 18, 2003, November 20, 2003, and December 1, 2003. The material information submitted for consideration is summarized below.

### SUMMARY OF FACTS

The Taxpayer currently has one class of common stock and three classes of preferred stock outstanding. During the time period described below, the Taxpayer's Common Stock has declined in value relative to the value of the Class 1 Preferred Stock, the Class 2 Preferred Stock, and the Class 3 Preferred Stock. As a result, the preferred stock shareholders' percentage of the outstanding equity value has increased although their actual preferred stock ownership has not changed.

#### Date 1

On Date 1, Taxpayer had a shares of Common Stock issued and outstanding. The Common Stock per share market price at the close of the day was \$b.

On the same date, Taxpayer issued preferred stock pursuant to a Preferred Stock and Warrant Purchase Agreement ("PSP1") with Shareholder A. Pursuant to PSP1, Taxpayer issued c shares of Class 1 Preferred Stock convertible into an aggregate of d shares of Common Stock at a conversion price of \$e, and two warrants to purchase an aggregate of f shares of Common Stock. The first warrant was a 5-year warrant to purchase g shares of Common Stock at an exercise price of \$h per share. The second warrant was a 7-year warrant to purchase g shares of Common Stock at an exercise price of \$i per share. Additionally, the Class 1 Preferred Stock contained a redemption feature allowing Taxpayer to redeem all or a portion of the Class 1 Preferred Stock on or after Date 3. In addition to PSP1, Shareholder A also purchased j shares of Common Stock in the open market on this date (the "Date 1 Purchase").

Immediately following PSP1 and the Date 1 Purchase, the total value of Shareholder A's interest in the equity interests of Taxpayer was approximately \$k (\$l Class 1 Preferred Stock and \$m Common Stock), representing approximately n% of the total value of all the stock interests in Taxpayer. As a result of other equity changes during the testing period coupled with PSP1 and the Date 1 Purchase, Taxpayer represents that it had an ownership change on Date 1 within the meaning of § 382(g)(1).

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Date 2

On Date 2, Taxpayer had o shares of Common Stock and c shares of Class 1 Preferred Stock issued and outstanding. The Class 1 Preferred Stock remained convertible into an aggregate of d shares of Common Stock. The Common Stock per share market price at the close of the day was \$p (an amount that is less than \$b).

On the same date, Taxpayer issued preferred stock pursuant to a Preferred Stock and Warrant Purchase Agreement ("PSP2") with an unrelated party (who was not previously a 5% shareholder). Pursuant to PSP2, Taxpayer issued q shares of Class 2 Preferred Stock, convertible into a maximum of r shares of Common Stock, and a warrant to purchase s shares of Common Stock at an exercise price equal to the conversion price of the Class 2 Preferred Stock of \$t.

Also on this date, Taxpayer issued preferred stock pursuant to a Preferred Stock Purchase Agreement ("PSP3"). Pursuant to PSP3, Taxpayer issued q shares of Class 3 Preferred Stock to Shareholder A at an issue price of \$u per share. Taxpayer also issued a letter to Shareholder A indicating that the redemption feature of the Class 1 Preferred Stock would be changed from an optional feature to a mandatory requirement as of Date 4.

Other Transactions

In addition to the above described transactions, since Date 1, the Taxpayer's only other actual owner shifts have resulted from the following: (1) a purchase of y shares of Common Stock by Shareholder A in the open market on Date 5 (a date between Date 1 and Date 2), (2) two issuances of stock for the exercise of common stock options, and (3) six sales of common stock by 5% shareholders.

Proposed Transaction

The Taxpayer will issue approximately \$w of additional stock to shareholders on or before Date 6 (the "Proposed Transaction"). Such issuance may include the issuance of stock to Shareholder A, a current 5% shareholder, other existing shareholders, new shareholders, or a combination thereof. The Proposed Transaction is intended to raise additional equity financing and/or be used to acquire additional business assets.

REPRESENTATIONS

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The following representations have been made in connection with the Proposed Transaction:

- (a) The warrants issued as a result of PSP1 and PSP2 were not issued with a principal purpose of avoiding or ameliorating the impact of an ownership change. Accordingly, they are not treated as exercised for purposes of determining whether an ownership change occurs.
- (b) No share of Taxpayer Common Stock, Class 1 Preferred Stock, Class 2 Preferred Stock, or Class 3 Preferred Stock has been redeemed during the current testing period.
- (c) Neither the Class 1 Preferred Stock, Class 2 Preferred Stock, or Class 3 Preferred Stock meets the description of stock described in § 1504(a)(4). Accordingly, the Class 1 Preferred Stock, Class 2 Preferred Stock, and Class 3 Preferred Stock constitute stock for § 382 purposes.
- (d) There have been no changes in the ultimate beneficial ownership of Shareholder A since Date 1, and no such changes are anticipated.
- (e) On Date 1, Taxpayer experienced an ownership change within the meaning of § 382(g)(1).
- (f) Taxpayer has not made any distributions to its shareholders or security holders of the stock and/or securities of any subsidiary corporation.
- (g) There have been no distributions to the shareholders or security holders other than in the normal course of business.

## RULINGS

Based solely on the information submitted and the representations as set forth above, we hold that the Taxpayer may apply the following principle on the testing date caused by the Proposed Transaction and on any subsequent testing date:

- (1) On any testing date, in determining the ownership percentage of any 5% shareholder, the value of such shareholder's stock, relative to the value of all other stock of the corporation, shall be considered to remain constant since the date that shareholder acquired the stock; and the value of such shareholder's stock relative to the value of all other stock of the corporation issued subsequent to such acquisition date shall also be considered to remain constant since that subsequent date.

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Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Further, in the event that any shareholder acquired stock prior to the beginning of the testing period, no opinion is expressed regarding whether the principle described above should apply to factor out the effect of fluctuations in value of such stock relative to the value of other stock that occur prior to the testing period.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the Taxpayer.

Sincerely,

Mark S. Jennings

Mark S. Jennings

Chief, Branch 1

Office of Office of Associate Chief Counsel  
(Corporate)

cc: